AGENCY PROBLEM ON CONCENTRATED OWNERSHIP AND ASSETS

I Putu Sugiartha Sanjaya
Atma Jaya Yogyakarta University

Abstract

The purpose of this paper is to investigate the difference in assets between the companies that have agency problem and no agency problem. Agency problem in this paper is peroxided by cash flow right leverage. Leverage indicates the difference between control rights and cash flow of controlling shareholder. If the control rights are greater than cash flow rights, it indicates there are agency problem in the company. It happens because the control of the controlling shareholder in the company is more dominant than the shareholder's claim to the company. This condition is incentive to motivate the controlling shareholder to extract the company's assets for his/her private benefit. This is attributable to the controlling shareholder protected by control rights. If the cash flow rights are high and as well as the control rights, it indicates that there is no agency problem in the company. This condition indicates that the claims value of the controlling shareholder against the company's profit is same as the control of the controlling shareholder. To prove empirical evidence, this paper uses the sample of the manufacturing companies listed in the Indonesian Stock Exchange during the period 2000-2007. The result of analysis of this paper shows that there are differences in assets between the existing agency problem and no agency problem. The assets of the company which exist the agency problem is lower than the assets of the company which is not agency problem. Therefore, the hypothesis of this study is supported.

Keywords: assets, agency problem, control rights, cash flow rights, cash flow right leverage.

I. INTRODUCTION

This study aims to extend the results of research conducted by Sanjaya (2011a) and (2011b). Sanjaya (2011a) found that public companies are owned by immediate (immediate ownership) which is still very limited. It is only 3.79% of all manufacturing firms listed on the Indonesia Stock Exchange (BEI) during the period 2001-2007. The remaining 96.21% public companies in the manufacturing industry are owned by ultimate (ultimate ownership). Ultimate ownership is the ownership either directly or indirectly to a public company. The largest ultimate owner is as the controlling shareholder (controlling shareholder). Controlling shareholder is individuals, families, or institutions (such as governments, financial institutions are widely held, widely-owned companies or others) who have control of a company either directly or indirectly at cut off certain control rights (Claessens et al., 2000).

According to Sanjaya (2011a), the public company dispersed ownership at cut off 10% control rights is 0.49%. Sanjaya (2011a) also found that almost all public companies in the manufacturing industry listed on the Stock Exchange are controlled by the controlling shareholder. Based on cut off 10% control rights, there are 99.51% of public companies in the manufacturing industries listed on the Indonesian Stock Exchange having a concentrated ownership structure. Although using cut off 20% control rights, the concentrated ownership of the manufacturing companies listed on the Stock Exchange is still high at 92.71%. Even with cut off 30% control rights, there are 81.82% of the public companies controlled by the controlling shareholder.

The results of Sanjaya (2011a) are not much different from some studies such as La Porta et al. (1999), Claessens et al. (2000), and Faccio and Lang (2002). Claessens et al. (2000). They suggest that the concentrated ownership of the public companies in Asia is the highest in the amount of 93%. Claessens et al. (2000) found that in many Asian countries there is still concentrated ownership above 90%, as Hong Kong (99.4%), Malaysia (99.0%), Singapore (98.6%), Thailand (97.9%), and Taiwan (97.1%). Concentrated ownership in Indonesia is higher than average the concentrated ownership of the public companies of the world which is recorded by La Porta et al. (1999) such as Europe, America, Asia, and Australia is 76% at cut off 10% control rights.

Based on this phenomenon, Sanjaya (2011b) conducted a subsequent study of agency problems which is occurred in Indonesia. An agency problem which is occurred in Indonesia is between controlling shareholder and non-controlling shareholders and not between manager and shareholder. Agency problem is demonstrated by the difference between control rights and cash flow rights. It is called the cash flow right leverage. The leverage is the source of agency problem in the concentrated ownership. The ownership mechanism which is used to increase the leverage is through pyramid structures. There is 63.97% owned by the pyramid at cut off 10% control rights.

Two studies of Sanjaya motivate the author to give evidence empirically whether the impact of these agency problem in the assets of the firm. As far as the authors know the research agency problem between shareholders and its impact on the assets of the firm has not been done in Indonesia. Therefore, the objective of this paper is to investigate empiricallywhetherthere is the different of assets between companies which have corporate agency problem and no agency problem.

II. THEORY AND HYPOTHESIS DEVELOPMENT

2. 1. AgencyTheory

To explain the agency problem in Indonesia, researchers should be more careful to indentify agency problem.The agency problem which is known by Jensen and Meckling (1976) between shareholders and managers is not appropriate to explain and predict the phenomenon of agency problem in Indonesia. Some researchers argued that the agency problems which is occurred in Indonesia is between shareholders and managers.

The ownership of the public companies in the United States and United Kingdom differ with the ownership of the public companies in East Asia including Indonesia and Eastern Europe. The ownership in the United States and United Kingdom are dispersed while the ownership in East Asia and Eastern Europe are concentrated. This phenomenon is demonstrated empirically by La Porta et al. (1999) and Claessens et al. (2000). In companies with dispersed ownership, individual shareholders can not control the management. Agency problem arising from the dispersed ownership is between manager and shareholder because manager is more control the company. In such cases, the manager will not act in the best interests of the shareholder because manager also increases to improve his personal benefit. It encourages managers to exploit the company's assets for his personal benefit. For the concentrated ownership, the company is controlled by the controlling shareholder. In fact, corporate manageris member of controlling shareholder family. In such case, the agency problem switches from shareholder and manager to controlling shareholder and non-controlling shareholders.

Shleifer and Vishny (1997) suggest the corporate governance is agency perspective which is referred as the separation between ownership and control. Managers control the company in the dispersed ownership. Manager obtainsfunds which are used productively to grow the company. Investors as owners need the good manager to manage the company for their return from the investment. In fact there is the issue how investors can convince themselves that they will receive return from their investment. This concern makes sense because managers tend to expropriation. Expropriation is the use of control to maximize their own welfare which harmsthe others (investors).

As a result of the expropriation, the shareholders substantially organized themselves into a controlling shareholder to get the information and closely monitor to manager. Controlling shareholder has a large enough control to pressure on manager. However, the new controlling shareholder leads agency problem because controlling shareholder control the company to satisfy personal benefit.In such case, the controlling shareholder takes benefit only for himself. It harms to non-controlling shareholders. It occurs because the control rights of controlling shareholders are more than cash flow rights. With the greater control rights, the controlling shareholder can influence the decisions of managers as to pay special dividends and exploit business relationships between companies which are in his/her control.

La Porta et al. (1999) is the first researcher to evaluate the potential agency problem between controlling shareholder and non-controlling shareholders whether the cash flow rights are substantially different from the control rights. According to Claessens and Fan (2002), agency conflicts occur because there is a large deviation between control rights and cash flow rights. If the cash flow rights of the controlling shareholderis close to or the same with the control rights, there is not the agency problembetween controlling shareholder and non-controlling shareholders. Controlling shareholder uses the strategy to own the company by of pyramid ownership and cross ownership to increase the difference between control rights and cash flow rights. The ownership of the company is represented by common stock.

The increase in control rights of common stock lead the controlling shareholder to expropriate the company's assets to increase his/her private benefits. With the strong control, the controlling shareholder can exploit the company's assets so that the company's value decreases. According to Shleifer and Vishny (1997: 759), "as ownership gets beyond a certain point, the large owners gain nearly full control and prefer to use firms to generate private benefits of control That are not shared by minority shareholders". The opinion of Shleifer and Vishny (1997) is consistent with the argument of the negative entrenchment effect which suggeststhat the controlling shareholder are motivated to use their control rights to her/his private benefit (Yeh, 2005).

The controlling shareholder with the strong control rights uses the company for personal benefit rather than the interests of non-controlling shareholders. It implies that there is entrenchment effect. According to Fan and Wong (2002), entrenchment is the act of the controlling shareholder which is protected by control rights for abuse of power such as expropriation (Fan and Wong, 2002). Fan and Wong (2005) and Yeh (2005) also confirmed the same to this argument.Entrenchment effects include the expropriation of the company's earnings which are transferred to other companies that are still controlled by the controlling shareholder. Controlling shareholder can also do the expropriation by the actions which do not maximize the company's earnings. Some researchers found the effect of entrenchment such as Claessens et al. (1999), Claessens et al. (2002), Lins

(2003), and Siregar (2006). The researchers documentedthat the increasing in the control rights of the controlling shareholdernegatively affect to the market value and dividends. These results confirme that the increasing of control rights will be the lower the value of the firm and the paid dividend.

The controlling shareholder also hasthe cash flow rights. This rights can prevent the controlling shareholder wishes to expropriate the non-controlling shareholders and the company. The biggerconcentration of the cash flow rights is incentive for the controlling shareholder to control company properly. It implies the effect of alignment. Alignment is the controllingshareholder actions are aligned with the interests of the non-controlling shareholder. The increasing of the cash flow rights in the hands of a controlling shareholder lead to increasing the financial incentives. The increasing of the cash flow rights will motivate controlling shareholder to align their interests with the company or a non-controlling shareholders.

Cash flow ownership by controlling shareholder can reduce the motivation of the controlling shareholder to expropriate the company's assets. Even the controlling shareholder desires to increase paid cash dividend (Jensen and Meckling, 1976). Cash flow rights are greater commitment to the controlling shareholders to no expropriate the company's assets (La Porta et al., 1999) because the expropriation alsoharms to the controlling shareholder (Claessens and Fan, 2002). Gomes (2000) also comments the same opinion.

Some researchers documented the implications of the alignment effect such as Claessens et al. (1999), La Porta et al. (2002), Claessens et al. (2002), and Siregar (2006). These researchers founded that the cash flow rights increase the value of the firm and dividend.

2.2. Common Stock

According to Hartono (2009), shareholder is the owners of the company that represents to management to manage the company's operation. As the owner of the company, the shareholder of the common stock has some rights such as the control rights, cash flow rights, preemptive rights, and rights of residual claims.

2.2.1. Control Rights

Control rights are the rights of common stockholders to elect the board of directors. This definition suggests that common stockholders have the right to control who will manage the company. Common shareholders can exercise their right to veto the election of the board of directors at the annual meeting of shareholders or veto the actions that require shareholder approval. According to Kim and Yi (2006), the control rights are the total percentage of shares held by common shareholders. Control rights are the rights of common stockholders to elect the board of directors and other policies such as the issuance of securities, stock splits, and substantial changes in the operating company (Du and Dai, 2005). According to La Porta et al. (1999), the control rights are the voting rights to participate in setting corporate policy.

In the context of ultimate ownership, control rights include direct and indirect control rights. Direct control rights are the percentage of the common stock owned by controlling shareholder on behalf of himself at a company. This right is the same as the direct cash flow rights. Indirect control rights are the sum of the minimum control in any chain of ownership (La Porta et al., 1999). Thus, the control rights are the amount of direct and indirect control rights.

2.2.2. Cash Flow Rights

Cash flow rights or the right to receive the company's profits is the right of common shareholders to receive part of company's profits. This right reflectshe right of common stockholdersto receive cash flow from the company's profits. Not all profits can be distributed.Some profits will be reinvested into the company that is often referred as retained earnings. Retained earnings are the company's internal resources. Retained earnings are not distributed as dividends. Not all companies pay dividends. If the company decides to divide the dividend, all common shareholders get dividends based on the percentage of cash flow rights. According to Kim and Yi (2006), cash flow rights are the percentage of shares held by controlling shareholder. Ownership refers to the cash flow rights (Du and Dai, 2005). Cash flow rights are financial claims against to the company (La Porta et al., 1999).

In the context of ultimate ownership, the right cash flow comprises the direct and indirect cash flow rights. The direct cash flow rights are the percentage of shares held by shareholders in public companies on his behalf. The indirect cash flow rights are the number of multiplications shareholders ownership percentage in each chain of ownership. Cash flow rights are the percentage of the direct and indirectlycash flow rights.

2.2.3. Preemptive Rights

Preemptive rights are the rights of the common stockholders to obtain the same percentage of stock ownership when the company issued additional shares. If companies do this, the number of outstanding shares will be more and consequently the percentage ownership of the last shareholders will drop. To maintain the percentage of ownership, the preemptive rights to give priority the last shareholders to purchase additional new shares so that the percentage of ownership does not change.

2.3. Previus Researchers

Claessens et al. (1999) investigated the relationship between corporate ownership structure in East Asia and the performance of the company. Claessens et al. (1999) found the concentration of cash flow rights increase the value of the firm. The control rights negatively affect to the value of the market. Wedge is a value that indicates the difference between the value of control rights and cash flow rights. The greater wedge between cash flow rights and control rights associated with a reduction in the value of the firm.Faccio et al. (2001) invesitaged the dividend behavior which connecte to the structure of the ownership and control. The sample in this study are companies in Europe and Asia. Faccio et al. (2001) found that the ratio of cash flow rights/control rights is positively related to dividends. This result confirms that the greater agency problem in the company will be less paid dividends.

La Porta et al. (2002) studied the effect of cash flow rights on the firm value. Samples were taken from 539 large companies in 27 countries. La Porta et al. (2002) found that cash flow rights has a positive effect on the value of the firm. It means thatthe increasing of the cash flow rights of the company will increase the value of the firm.Claessens et al. (2002) studied the effect of ownership structure of public corporations in East Asia against to the value of the firm. Sample is taken from the 1301 companies in 8 countries of East Asia. The results of Claessens et al. (2002) are consistent with previous research that the increasing of the cash flow rights will increase the value of the firm. However, Claessens et al. (2002) found that the control rightsnegatively effect to the velue of the firm. It means that the increasing of the control rights of controlling shareholder will decrease the value of the firm.

Lins (2003) studied the relationship between stock ownership by management and stock ownership non-management blockholder and the value of the firm in 18 emerging market countries. Lins (2003) found that the velue of the firm will be lower when management control by the larger companies. Lins (2003) also found the positive association between non-management blockholders and the value of the firm for countries which apply low legal protection.Lemmon and Lins (2003) studied the differences in the corporate ownership structure which can explain differences in the performance of the company during the financial crisis in East Asia on July 1997. Data were collected from Woldscope for 800 companies in East Asia. Lemmon and Lins (2003) measures the degree of separation of ownership and control which is indicated by the cash flow right leverage. Lemmon and Lins (2003) found that the value of the firm is negatively related to the separation of cash flow rights and control rights.

Siregar (2006) studied the effect of cash flow rights, control rights and cash flow right leverage on the value of the firm and dividends. Siregar (2006) used all companies listed on the Jakarta Stock Exchange. Siregar (2006) found that the cash flow rights positive effect on the value of the firm and cash dividends. The control rights negative effect to cash dividends.

2.4. The Research Hypothesis

Claessens et al. (1999) empirically investigated the influence of the corporate ownership structure in East Asia to the performance of the company. Researchers were using the wedge that shows the difference between control rights and cash flow rights of controlling shareholder. Wedge is also often referred to as cash flow right leverage. Claessens et al. (1999) found that the wedge negatively affect the value of the company. This means the wedge or cash flow rights leverage as a proxy for agency problem affect firm value. The increasing cash flow rights leverage means the increasing agency problem which reduce the value of the firm.Faccio et al. (2001) investigated the dividend behavior which is related to the structure of ownership and control. The sample in this study iscompanies in Europe and Asia. Faccio et al. (2001) used the ratio of cash flow rights divided by control rights. If this ratio is greater, the agency problem in the company is small. Conversely if the ratio is smaller,the agency problem in the company is large. Faccio et al. (2001) found that cash flow rights/control rights is positively related to dividends. This result indicates that the company is not interested to pay dividend as the greater agency problem in the company. Conversely, the company is interested to pay dividend as the smaller agency problem.

Lemmon and Lins (2003) investigated the differences in corporate ownership structures which are used to explain differences in performance of the company during the financial crisis in East Asia in July 1997. Researchers used the cash flow right leverage to measure degree of difference between control rights and cash flow rights. Leverage is calculated as the ratio of control rights to cash flow rights. Lemmon and Lins (2003) found the negative value of the company which is related to the difference between cash flow rights and control rights.Siregar (2006) investigated the effect of control rights and cash flow right leverage on the value of the firm and dividends. Siregar used the company listed on the Indonesian Stock Exchange. Siregar (2006) found that cash flow rights leverage which is interacted with shareholder engagement as manager of the company negatively affect to dividend.

There are some negative impacts the increasing agency problem for companies and non-controlling shareholders. In the context of concentrated ownership, agency problem is peroxidedby difference between cash flow rights and control rights of controlling shareholder. This difference is often referred as cash flow right leverage. The leverage is calculated by the control rights minus cash flow rights of controlling shareholder. If the leverage is greater,it indicates a large agency problem because control of the company by controlling shareholder is greater than the claim to corporate profits by controlling shareholder. This condition encourage controlling shareholder to expropriate the company's assets for personal benefit. These conditions indicate the implications of entrenchment effect of controlling shareholder.Conversely if the leverage is smaller,it indicates a small agency problems because cash flow rights of controlling shareholder which is close or same with the control rights. If the controlling shareholder expropriate the company's asset, the controlling shareholder also loses because the controlling shareholder will reduce his/her claims for the company's profit. This condition describes the implications of the alignment effect of the controlling shareholder.

Based on the conditions, the author expects that the greater agency problem leads the controlling shareholder to make expropriate. This expropriation can reduce the company's assets. Conversely, the smaller agency problem is condition which is less opportunity for controlling shareholder to make expropriation. This conditions do not lose the company's assets due to expropriation. In such cases, the authorexpect that there is a difference between company's assets between companies which have agency problem and companies which do not have the agency problem. To test this expection empirically, this paper formulates the following research hypothesis.

***H_a*: there is a difference between assets between the companywhich has agency problem and the company has not agency problem.**

III. RESEARCH METHOD

3. 1. Sample

Sample of this study is manufacturing companies listed on the Indonesian Stock Exchange from 2000 to 2007. Sampling was done by purposive sampling because the author wants specific information from the target as manufacturing industries listed since 2000 and publishes the annual financial statements from 2000 to 2007.

3. 2. Data Collection

Data collection techniques of this study are the data archive. One form of collection of archived data is secondary data. Secondary data obtained from several sources as Indonesian Stock Exchange for the audited financial statements, OSIRIS database for ultimate ownership, and Indonesian Business Data Centre for ultimate ownership.

3. 3. Research Variable and Measurement

Cash flow rights is the percentage of shares held by controlling shareholder (Kim and Yi, 2006). Ownership refers to the cash flow rights (Du and Dai, 2005). Cash flow rights are financial claims against to the company (La Porta et al., 1999). Cash flow rights consist of direct and indirect cash flow rights. Direct cash flow rights is the percentage of shares held by shareholder in public companies on behalf of himself. Indirect cash flow rights is the number of multiplications shareholders ownership percentage in each chain of ownership. Cash flow rights is the sum of the percentage of direct and indirect cash flow rights.

Control rights is the total percentage of shares held by controlling shareholder (Kim and Yi, 2006). Control rights are the rights of common stockholders to elect the board of directors and company policies such as the issuance of securities, stock splits, and substantial changes in the operating company (Du and Dai, 2005). According to La Porta et al. (1999), control is the voting rights to participate in setting corporate policy.Control rights include the direct control rights and the indirect control rights. The direct control rights are the percentage of shares which is held by controlling shareholder on behalf of himself at a company. The direct control rights is equal direct cash flow rights. Indirect control rights is the sum of the minimum control in any chain of ownership (La Porta et al., 1999). Control rights is the sum of the relationship between the direct control rights and indirect control rights.

Cash flow rights leverage is the difference between control rights and cash flow rights. The cash flow rights leverage is the value which is obtained from control rights minus cash flow rights. The greater difference between cash flow rights and control rights suggests the higher the increasing control rights exceed cash flow rights. There are some researchers refer to this as a leverage ratio of cash flow rights to control rights (Faccio et al., 2001; Lemmon and Lins, 2003). In this paper, the agency problem is proxided by the cash flow right leverage. Cash flow rights leverage is greater than zero indicates there is agency problem in teh company. While cash flow rights leverage equals zero indicating no agency problem.

According to SFAC No 6 (FASB, 2008), assets are probable future economic benefits obtained or controlled by a particular entity as result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit involves a capacity, single or in combination with other assets, to contribute directly or indirectly to future net cash flows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. Assets commonly have other features that help identify them.

IV. RESULTS

4.1. Descriptive Statistics

The following descriptive statistics results are shown in Table 1 as follows.

Table 1. Descriptive Statistics

	KEAGENAN	N	Mean	Std. Deviation	Std. Error Mean
ASSET	.00	539	2977187641726.9120	8042307381737.82000	346406701739.34920
	1.00	247	1914893003908.7490	3788926530754.78400	241083621955.39430

The output of the descriptive statistics in Table 1 show that the number of sample in the category no agency problems are 539. The mean value of the company's assets that do not have the agency problem is Rp2.977.187.641.726, 91. The numbers of sample in the category which have agency problem are 247. The mean value of the company's assetswhich has agency problem is Rp1.914.893.003.908, 75.

These results indicate that the values of the company's assets which do not have agency problem are larger than companies which have agency problem. Ithappens because the controlling shareholders may expropriate the company's assets. To further test whether statistically significant differences in the value of the assets between companies which do not have the agency problem and which have agency problem.

4.2. The Result of Hypothesis Test

The results of hypothesis test are shown as follows.

Table 2. The result of Hypothesis Test

		Levene's Test for Equality of Variances		t-test for Equality of Means						
									95% Confidence Interval of the Difference	
		F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
ASSET	Equal variances assumed	13.313	.000	1.977	784	.048	1062294637818.1630	537245140476.06800	7685415218.01889	2116903860418.30800
	Equal variances not assumed			2.517	783.429	.012	1062294637818.1630	422041367386.02520	233828846939.66540	1890760428696.66100

The analysis in Table 2 shows that the mean difference between companies which have agency problem and have no agency problem is Rp1.062.294.637.818.16. This value is obtained from the mean value of the company's assets in companies which do not have the agency problem is Rp2.977.187.641.726, 91 and the mean value of the company's assetswhich has agency problem is Rp1.914.893.003.908, 75.

Based on the result of the testing hypothesis indicate that there are differences in assets between the companies which have agency problem and have no agency problem at the alpha 5%. These results support the notion that agency problem which occur in the context of the concentrated ownership is still happening between controlling shareholder and non-controlling shareholders. Agency problemharms to non-controlling shareholders such as decreasing value of company or company's assets. The results support several previous studies such as Claessens et al. (1999) and Lemmon and Lins (2003). Based on the analysis of this data, the research hypothesis states that there is a difference company's assetbetween company which has agency problems and no agency problems are supported.

V. CONCLUSION

This paper concludes that the agency problem between controlling shareholder and non-controlling in the context of the corporate ownership. Some of the opinion states that there is no agency problem on one side can be justified if the opinion is based on the view of Jensen and Meckling (1976) that the conflict is between the manager and owner. It is less probability to happen and may be almost non-existent because the manager is mostly from family members of the controlling shareholder. On the other hand, this opinion is not quite right, in Indonesia the agency conflict still remains between the owners and the owners such as the controlling shareholder and non-controlling shareholders.

Based on the results of research in this paper concludes that the agency conflict which cause the company's assets is lower for the companies which have agency problem. This occurs because the controlling shareholder only uses the company as a cash cow to satisfy personal interests. It is shown by the difference between control rights and cash flow rights of controlling shareholder who motivate and protect controlling shareholder to expropriate the company's assets for privatebenefit.

Limitations of this study are thatthis research is only to test two mean of assets between the companies has agency problem and company has no agency problem. In such cases, this study does not control other factors which cause why the company's assets in companies with agency problems is lower than the company which is no agency problem. This study only focuses on manufacturing companies so the generalization of the results of this study is relatively low.

Subsequent research could study the causality the effect of the agency problem to asset by considering several other variables which affect the company's assets. The study is a preliminary study in Indonesia which investigates the difference between control rights and cash flow rights the controlling shareholder as a proxy for agency problem and assets. Therefore, the results of this study can still be developed in subsequent research.

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